DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 00-0434
Indiana Adjusted Gross Income Tax
Tax Administration—Penalty
For Tax Years 1996-1999

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ISSUES

I. Indiana Adjusted Gross Income Tax—Applicability of the Throwback Rule

Authority:

IC § 6-3-1-3.5
IC § 6-3-2-1
IC § 6-3-2-2
IC § 6-8.1-5-1(b)
45 IAC 1-1-119
45 IAC 3.1-1-53
45 IAC 3.1-1-64

Public Law 86-272 (15 USCS § 381)

***Wisconsin Department of Revenue v. William Wrigley, Jr. Co.*, 505 U.S. 214; 112 S. Ct. 2447; 120 L.Ed.2d 174 (1992)**

Taxpayer protests the "throwback" to Indiana of sales of goods delivered to Kentucky.

II. Tax Administration—Penalty

Authority: **IC § 6-8.1-10-2.1** **45 IAC 15-11-2.1**

Taxpayer protests the imposition of the 10% negligence penalty.

STATEMENT OF FACTS

Taxpayer is a retail merchant who manufactures wooden skids for sale at wholesale to other manufacturers who use the skids to ship finished goods to their customers. Taxpayer also sells the skids to customers for their own use. Taxpayer's commercial domicile is in Indiana. Taxpayer ships the skids in-state and out-of-state on common carriers or on vehicles from its company fleet. The Department audited taxpayer for tax years 1996-1999 and determined that sales to Kentucky should be "thrown back" to Indiana because Kentucky had no jurisdiction to tax the sales under Public Law 86-272 (15 USCS § 381) and relevant case law. Taxpayer timely protested and an administrative hearing was held. Additional facts will be provided as necessary.

I. Indiana Adjusted Gross Income Tax—Applicability of the Throwback Rule

DISCUSSION

Taxpayer protests the "throwback" to Indiana of receipts from sales of goods shipped to Kentucky. The issue in this case is whether or not taxpayer is taxable in Kentucky based on the sale and shipment of goods manufactured in Indiana, or must the receipts be "thrown back" for inclusion in the numerator of the taxpayer's sales factor for purposes of the Indiana Adjusted Gross Income Tax. Taxpayer already files tax returns in Kentucky.

Under IC § 6-8.1-5-1(b), a "notice of proposed assessment is *prima facie* evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

IC § 6-3-1-3.5, subsection (b), defines "adjusted gross income" for corporations as "the same as 'taxable income' (as defined in Section 63 of the Internal Revenue Code)" with four adjustments not at issue here. IC § 6-3-2-1 establishes the rate of the tax imposed on adjusted gross income; IC § 6-3-2-2 defines "adjusted gross income derived from sources in Indiana." Subsection (n) states that a "taxpayer is taxable in another state if:

> (1) in that state the taxpayer is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax; or
> (2) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.

With respect to Indiana's adjusted gross income tax statute, 45 IAC 3.1-1-53 provides in pertinent part:

> When Sales of Tangible Personal Property Are in This State. Gross receipts from the sales of tangible personal property (except sales to the United States Government—See Regulation 6-3-2-2(e)(050) *[45 IAC 3.1-1-54]* are in this state: (a) if the property is delivered or shipped to a purchaser within this state regardless of the F.O.B. point or other conditions of sales; or (b) if the property is shipped from an office, store, factory, or other place of storage in this state, and the taxpayer is not taxable in the state of the purchaser.

Subsection (5) provides in pertinent part:

> If the taxpayer is not taxable in the state of the purchaser, the sale is attributed to this state if the property is shipped from an office, store, warehouse, factory, or other place of storage in this state. Such sale is termed a "Throwback" sale.

45 IAC 3.1-1-64 defines "taxable in another state" as "when such state has jurisdiction to subject it to a net income tax. This test applies if the taxpayer's business activities are sufficient to give the state jurisdiction to impose a net income tax under the Constitution and laws of the United States. **Jurisdiction to tax is not present where the state is prohibited from imposing the tax by reason of the provision of Public Law 86-272, 15 U.S.C.A. § 381-385.**" **(Emphasis added).** Taxpayer argues Kentucky has jurisdiction to tax the gross receipts from sales to its Kentucky customers. Taxpayer has alleged it has filed Kentucky tax returns and paid Kentucky taxes on the sales at issue.

During the hearing, taxpayer's representative was asked to provide additional facts in order to determine whether Kentucky has jurisdiction to tax such that the receipts from sales to Kentucky customers do not fall within the ambit of Indiana's throwback rule. Taxpayer's representative has provided the requested additional information.

Taxpayer delivers wooden skids to 2 customers in Kentucky. One receives product 2-3 times per week. (Customer X). The other (Customer Y) has changing production lines, so the skids need to be redesigned to fit the new production lines. One of taxpayer's employees goes to Y's place of business to gather information in order to redesign the skids, every time it is necessary. The driver delivering skids to X takes inventory each time he makes a delivery, and taxpayer determines what and when X needs more product, based on that inventory. Also, one of taxpayer's drivers will take a forklift to X's place of business to move and straighten out the inventory when necessary.

Taxpayer also performs the following at both Kentucky customers' business locations, and in Kentucky generally:

1. Making repairs or providing maintenance or service to the property sold or to be sold.
2. Providing technical assistance
3. Investigating, handling and assisting in resolving customer complaints
4. Owning, using, or maintaining property in the taxing state (trailers on site for warehousing and company owned forklifts used in taxing state.)
5. Transport and replacement of damaged product.
6. Product delivered into Kentucky by company owned vehicles, "irrespective of whether a shipment or delivery fee or other charge is imposed, directly or indirectly, upon the purchaser."

Public Law 86-272 provides in pertinent part:

> No State . . . shall have power to imposes, for any taxable year. . . , a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

> (1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and
> (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1)

15 USCS § 381(a).

The United States Supreme Court, in *Wisconsin Department of Revenue v. William Wrigley, Jr. Co.,* 505 U.S. 214, 112 S.Ct. 2447, 120 L.Ed.2d 174 (1992), construed the above statutory language to hold that a business's in-state activities could subject it to that state's taxing jurisdiction if those activities involved more than the "mere solicitation of orders" and more than *de minimis* contact in connection with the solicitation of orders. The Court set forth a method of analysis by which to determine whether or not a business's in-state activities cause it to lose the tax immunity 15 USCS § 381 confers: "Section 381 was designed to increase . . . the connection that a company could have with a State before subjecting itself to tax. Accordingly, whether in-state activity other than 'solicitation of orders' is sufficiently *de minimis* to avoid loss of the tax immunity conferred by § 381 depends upon whether that activity establishes a nontrivial additional connection with the taxing State." Unless activities are "ancillary to" ordering product or *de minimis*, then a business can be taxed in another jurisdiction without that jurisdiction violating § 381. The activities taxpayer engages in—customizing skids for customer Y; handling customer complaints on-site, conducting repairs, maintenance, service, and technical assistance on site; maintaining property (trailers and forklifts) in Kentucky; and using company owned vehicles rather than common carriers to transport products into Kentucky— are activities that are not ancillary to processing orders, and they create much more than a "non trivial connection with the taxing state" of Kentucky. Taken together, these activities exceed the *de minimis* standard set by § 381 and explicated by *Wrigley*. Taxpayer is taxable in Kentucky and therefore receipts from sales to customers in Kentucky are not subject to Indiana's throwback rule.

FINDING

Taxpayer's protest concerning the applicability of Indiana's throwback rule to receipts from sales to Kentucky customers is sustained.

II. Tax Administration—Penalty

Taxpayer protests the imposition of the 10% negligence penalty. Taxpayer argues that it had reasonable cause for its failure to pay the appropriate amount of tax due; the failure was based solely on taxpayer's interpretation of the relevant statutes and regulations.

Indiana Code Section 6-8.1-10-2.1(d) states that if a taxpayer subject to the negligence penalty imposed under this section can show that the failure to file a return, pay the full amount of tax shown on the person's return, timely remit tax held in trust, or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall waive the penalty. Indiana Administrative Code, Title 45, Rule 15, section 11-2 defines negligence as the failure to use reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence results from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by Indiana's tax statutes and administrative regulations.

In order for the Department to waive the negligence penalty, taxpayer must prove that its failure to pay the full amount of tax due was due to reasonable cause. Taxpayer may establish reasonable cause by "demonstrat[ing] that it exercised ordinary business care and prudence in carrying or failing to carry out a duty giving rise to the penalty imposed. . . ." In determining whether reasonable cause existed, the Department may consider the nature of the tax involved, previous judicial precedents, previous department instructions, and previous audits.

In the present case, as to the successfully protested items, taxpayer's reliance on the law was reasonable; however, taxpayer presented no arguments or evidence as to the remaining items.

FINDING

Taxpayer's protest concerning the 10% negligence penalty assessed on the successfully protested items is rendered moot by the prior finding in this Letter of Findings. The remainder of the penalty stands.

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